

Service Date: February 18, 1988

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER of the Application of)	
the TOWN OF CASCADE for Authority to)	UTILITY DIVISION
Increase Rates and Charges for Water)	DOCKET NO. 87.9.48
Service in its Cascade, Montana Service))	ORDER NO. 5329
Area.)	
_____)	

APPEARANCES

FOR THE APPLICANT:

John Doubek, Attorney at Law, Small, Hatch, Doubek and
Pyfer, Livery Square, Helena, Montana 59601.

FOR THE INTERVENORS:

Mary Wright, Staff Attorney, Montana Consumer Counsel, 34
West 6th Avenue, Helena, Montana 59620.

FOR THE COMMISSION:

Robin McHugh, Staff Attorney, 2701 Prospect Avenue, Helena,
Montana 59620.

Ron Woods, Rate Analyst, 2701 Prospect Avenue, Helena,
Montana 59620.

BEFORE:

Clyde Jarvis, Commissioner and Chairman
Howard Ellis, Commissioner
Tom Monahan, Commissioner

BACKGROUND

1. On September 11, 1987, the Town of Cascade (Applicant or Town) filed an application with this Commission for authority to increase rates and charges for water service to its customers in its Cascade, Montana service area. The Applicant requested an average increase of approximately 188%, which constitutes an increase of approximately \$85,720 in annual revenues.

2. On November 24, 1987, following issuance of proper notice, a hearing was held in the Wedsworth Hall, Cascade, Montana. For the convenience of the consuming public there was also a night session, held at the same location. The purpose of the public hearing was to consider the merits of the Applicant's proposed water rate adjustment.

ANALYSIS AND FINDINGS OF FACT

3. At the public hearing the Applicant presented the testimony and exhibits of the following witnesses:

Earl Damon, Mayor, Town of Cascade
Gary Sanderson, Town Superintendent
Barbra Hitt, Town Clerk
Gus Byrum, Montana Department of Commerce
Rick Rosa, Montana Department of Health
Jim Cummings, Consulting Engineer

These witnesses testified relative to the need for proposed capital improvements, the estimated cost of the proposed capital improvements, the financing of proposed capital improvements, debt service obligations, and rate structure.

4. During the course of the public hearing the Montana Consumer Counsel presented the testimony of 9 public witnesses. The majority of the public witnesses expressed opposition to the Town's

proposed water rate increase. In general these consumers were of the opinion that the capital improvement program outlined in the filing was too aggressive and expensive for the community of Cascade to undertake. They also suggested that the proposed rate increase would have a deleterious impact on consumers having a low to moderate income.

CAPITAL IMPROVEMENT PROGRAM

5. The Town in its application has set forth a proposed capital improvement program for the water utility. The total estimated cost of the capital improvements as outlined by the Town is \$1,092,000. The following Table 1, sets out the proposed costs associated with the capital improvements program.

TABLE 1

1. Administration	\$ 22,900
2. Engineering Fees	\$ 62,200
3. Construction Inspection	\$ 41,600
4. Distribution Improvements	\$725,800
5. Transmission Improvements	\$ 49,200
6. Source of Supply Improve.	\$150,000
7. Interim Financing	\$ 10,000
8. Contingency	<u>\$ 30,200</u>
Total	\$1,092,000

6. The Town proposes that construction of the capital improvements under consideration in this Docket be funded from

various sources. The following is a listing of the funding sources and the amounts:

1. Water Revenue Bonds	\$525,000
2. Department of Natural Resources - Loan	\$200,000
3. Community Development Block Grant	\$350,000
4. Gas Tax Funds - for street repair	\$ 80,000
5. Interest Earnings During Construction	<u>\$ 8,000</u>
Total Funds Available	\$1,163,000

The Water Revenue Bonds and the Department of Natural Resources (DNRC) loan would be funds that require repayment by water utility subscribers. The remainder of the funding sources do not require repayment and therefore, have no impact on the rates assessed water utility customers.

7. The expenses listed in items 1, 2, 3, 7, and 8 of the proposed capital improvement program (Table 1) are usual costs included in the cost estimate for a municipal water utility construction project. The magnitude of these expenses generally varies depending on the scope and duration of the construction project and are difficult to quantify. These costs have historically been accepted, without specific examination by the Commission, if the balance of the capital improvement program is found to be reasonable and prudent.

8. The Town's proposed water system improvement program, as testified to by the Town's witnesses, includes "...the replacement of existing deteriorated undersized cast iron mains, looping of

distribution lines, replacement of inoperable valves and unreliable hydrants throughout the system. Improvements will be made to the water supply to provide an adequate supply that meets water quality standards" (Applicant's Exhibit No. 2, Section 3, page 11).

9. The Applicant's witnesses testified that significant problems are being experienced with the water utility's existing facilities. Some of the distribution system deficiencies identified by the witnesses include: under sized pipelines that create inadequate fire flows, excessive amounts of lost and unaccounted for water, inadequate pressures, increasing number of pipeline breaks on the system not confined to a specific area, deteriorated water valves that have failed in the closed position causing water pressure problems.

The Town's witnesses indicated that the existing spring sources, which the Town wants to abandon, are in probable violation of the Safe Drinking Water Act. They further indicated that if the Town wants to continue use of the springs as a source of supply for its water system, substantial rehabilitation of the spring boxes will be required by the Montana Department of Health to insure that contamination of this source does not occur.

10. It is the Commission's impression based upon the testimony received in this Docket that no dispute exists relative to the need

for capital improvements to the water system. The Commission's impression regarding need for improvements is reinforced by the submission of an alternative plan for water system improvements by a citizens' group. The alternative plan proposed by the citizens' group recognizes a need for all improvements outlined by the Town in its submission. The only difference between the plans submitted by the Town and the citizens' group are the costs associated with construction of the improvements. The citizens' group suggests in its submission that it can construct all proposed improvements for an estimated cost of \$547,739 as opposed to the Town's estimate of 1,092,000.

11. The Commission finds, based upon the testimony in this Docket, that the capital improvement program as proposed by the Town is reasonably prudent and therefore accepts the Town's assertion that the improvements outlined in the filing need to be constructed.

CONSTRUCTION COSTS

12. As stated previously the Commission finds that the main area of disagreement, between the Town and the citizens testifying at the hearing, is not whether the capital improvements need to be

made, but rather, what scope of capital improvements should be undertaken and at what annual cost to the ratepayer. The Commission agrees with the consumers that the issue of scope and cost are issues that deserve scrutiny in this order.

13. The statutory authority of this Commission to regulate municipally owned public utilities allows for the examination and modification of both the scope of a construction program to be undertaken, and the financing proposal necessary to implement it. In this particular Docket the Commission's ability to exercise general regulatory control over the scope of the construction program is constrained to a significant degree. The Town has obtained funding for construction of capital improvements to its water system through the Community Development Block Grant program (CDBG), which does not require repayment of the funds. The Town's involvement in the federally funded CDBG program materially limits the Commission's ability to modify the scope of the improvement program, if it is determined that the \$350,000 in federal funding should be retained in the financing proposal to defray construction costs that would otherwise be recovered from ratepayers.

The CDBG funding program is competitive; therefore, in order to obtain this funding the Town had to prepare and submit an application to the Montana Department of Commerce which is the

local agency administering these funds in the State of Montana. Included as part of that application is the scope of the improvement program under consideration, the cost of the program, a financing proposal and the number of low to moderate income persons residing in the area affected by the proposed improvement program. Based upon this and other information contained in the CDBG application, the Town's request for funding is given a point total that determines its ranking in the competition for the federal funds available through this program. If the applicant's ranking is high enough it is awarded a CDBG.

14. During the public hearing a representative of the Department of Commerce, the agency administering the CDBG funding, indicated that if the Commission modified any facet of the Town of Cascade's proposed capital improvement program, the Town's CDBG funding could be jeopardized. The Department representative stated that any modification of the improvement program proposal represents an amendment to the CDBG application on which funding has been authorized and would have to be reviewed by the Department. The review by the Department would consist of assignment of new point totals, based upon the amended application, with the new point total establishing a revised ranking for the Town in the funding competition. While not committing to a specific position on

the outcome of CDBG funding for the Town, based on an amended application, the indications were that re-ranking of the Town's application may jeopardize, and would certainly delay funding from this competitive source.

15. Since in the Commission's view any amendment to the Town's proposed capital improvement program, scope or cost, risks losing CDBG funding, the question boils down to whether it is cheaper to finance the proposed improvements with or without the grant money. The Commission has been presented with two cost estimates for the same scope of water utility improvements, one being the Town's totalling \$1,092,000 and the other being the citizens' group totalling \$547,739.

16. The Town's estimate of construction costs that will be financed through the issuance of revenue bonds and a DNRC loan and repaid by the ratepayers totals \$725,000. This source of funding has an annual cost of approximately \$100,000. Of this \$100,000 approximately \$21,000 will be unencumbered funds, generated by a coverage ratio. The funds generated by the coverage ratio would be available to the utility to meet ongoing capital maintenance requirements and ensure adequate maintenance of utility facilities.

17. Under the citizens' proposal the Commission must assume that the CDBG funding will not be available and that all costs of

the proposed capital improvement program totalling \$547,739 will be borne by ratepayers. If the Commission adopts the proposal of the citizens' group the Town will have two options available for implementing the improvement program. The first option would be to implement a phased construction program with funding for construction coming from the current revenues of the utility and the second would be to issue local revenue bonds in the amount of the estimated construction costs. It is doubtful, given the nature of the bond market, that a town the size of Cascade would be able to issue a revenue bond that allowed the local governing body to be the contractor for major system improvements. Therefore, the Commission will confine its discussion of costs, associated with the capital improvement program, to phased construction.

The term of the bonds proposed by the Town in this filing is 20 years; therefore, the Commission will discuss phased construction over a 20 year period. To fund the construction program and costs outlined in the citizen group's proposal, assuming a 10% annual adder for phasing of the construction and inflation, the Commission would have to authorize an annual revenue increase of approximately \$78,429. This amount of annual revenue increase would fund the construction of those items contained in the improvement program over a 20 year period.

The \$725,000 revenue bond issue proposed by the Town anticipates a maximum principal and interest payment on the bonds, of \$79,456 plus a 25% coverage factor, for a maximum debt service of \$100,000. The revenue increase calculated to fund a 20 year construction program closely approximates the annual principal and interest payment on the proposed revenue bonds. But when you include the 25% coverage requirement of the revenue bond in the cost comparison the phased construction requires approximately \$21,600 less in annual funding. Clearly, when viewed in the context of funding only the improvements outlined in the proposed program, it is cheaper to fund the phased construction than to issue revenue bonds.

The present capital maintenance requirements of the Town's water utility are not the only consideration that must be addressed over the 20 year term of the bonds, or phased construction period. Prudent management and regulation dictates recognition of a requirement for additional on-going capital maintenance funding above and beyond the current needs for major reconstruction. The Town has an obligation to maintain reasonably adequate facilities for the provision of water service. If additional funding for on-going capital maintenance is not authorized and the water utility facilities deteriorate, it is the fault of the regulator and the

manager for failing to recognize the genuine need for this type of funding. The citizens' proposal does not recognize a need for additional on-going capital maintenance funding, which the Commission has long supported and can be funded through the coverage ratio on the bond. If the Commission adds an amount to the citizens proposal to fund on-going maintenance then the attractiveness of that phased construction funding method, when compared to the revenue bond, diminishes.

18. The Commission lauds the initiative of the citizens' group in putting together an alternative plan for construction of needed capital improvements to the water system; but based on the foregoing discussion, the Commission finds that the Town's financial proposal is reasonable.

DEBT SERVICE

19. The Town proposes to finance the bulk of the capital improvements outlined in this proceeding through the issuance of \$725,000 in revenue bonds. \$200,000 of the proposed revenue bonds will be purchased by DNRC, with repayment over a 20 year term and carry an interest rate of 7.23%. The balance of the revenue bonds to be issued, \$525,000, would be series 1987 water revenue bonds having a repayment period of 20 years with the requirements that the Town capitalize from the bond proceeds a reserve fund in an

amount equal to the maximum principal and interest payment on all outstanding bonds and provide a debt service coverage of 125%.

20. In any sale of municipal bonds, the purchasers of the bonds must be assured that their investment is secure. To provide this security, the municipality makes a promise, called a covenant, to do certain things that will ensure that it will always be able to pay the bonds principal and interest as they come due. In this instance, the Town proposes to include covenants agreeing to the establishment of a bond reserve fund in an amount equal to the maximum principal and interest on all outstanding bonds, in the amount of \$79,456, which will be capitalized from bond proceeds and coverage ratio of 125%.

21. The Commission finds the bond covenants, establishment of a reserve fund, and the 125% coverage ratio, to be among the standard requirements for the issuance of revenue bonds and, therefore, accepts the requirements.

22. The Commission finds the issuance of \$725,000 in revenue bonds with a maximum term of 20 years and a maximum interest rate of 9.0% on \$525,000 in bonds and 7.23% on \$200,000 in bonds, with the requirements that the Town establish a bond reserve in an

amount equal to the maximum principal and interest payment on the bonds and provide a debt service coverage of 125%, is appropriate.

23. When the Town completes the sale of the proposed revenue bonds it will incur a maximum principal and interest payment on all outstanding revenue bonds of approximately \$79,456. It will also incur the obligation to have a net operating income of at least \$19,864 to meet the requirement that it achieve a 125% coverage ratio. The required net operating income is calculated by multiplying the maximum principal and interest payment on outstanding bonds by 25% ($\$79,456 \times .25 = \$19,864$).

OPERATION AND MAINTENANCE EXPENSE

24. The test year operation and maintenance expenses totalling \$35,000 were not challenged by any party participating in this proceeding. The test year operation and maintenance expenses presented by the Applicant are accepted by the Commission.

25. The Commission finds the following test year operating revenue deductions to be reasonable:

Operating Expense	\$35,000
Debt Service	\$79,456
Debt Service Coverage	<u>\$19,864</u>
TOTAL	\$134,320

The test year expense assumes full annualized costs for the proposed revenue bond issue. The Commission chooses to calculate expenses in this manner, as it is the most reasonable way of

accounting for the effect of the proposed bond issue on the operating statement of the utility.

REVENUE NEED

26. The Town indicated that, under present rates annual revenue generation would be approximately \$45,656. The Applicant also indicated that the water utility would generate \$3,798 in interest earnings, resulting in total operating revenues of \$49,454. The test period operating revenues were not a contested issue in this case and are, therefore, accepted by this Commission.

27. The Commission, based upon the Findings of Fact contained herein, finds that the Applicant should be allowed to increase revenues by \$84,866. This requirement is calculated as follows:

Operating Revenue	\$49,454
LESS:	
Operating Expense	\$35,000
Debt Service	\$79,456
Debt Service Coverage	<u>\$19,864</u>
Total Revenue Requirement	\$134,320
REVENUE DEFICIENCY	\$84,866

RATE DESIGN

28. The Applicant's proposed rate structure is designed to generate total annual revenues of \$131,402 and represents an annual

revenue increase totalling \$85,746. The proposed rate structure represents a continuation of the current water rate structure, with the increased revenues being generated by application of essentially a uniform percentage increase to all water services.

29. During the course of the public hearing it was brought to the Commission's attention that the Town of Cascade, as a subscriber to water utility service, was being provided service at no charge. It is contrary to statute (69-3-305, MCA) for a utility to provide service at no charge to a consumer, even if the consumer is the owner of the utility. The City's water utility is an enterprise operation, which means it is a self supporting fund within the local government and should receive compensation from the appropriate Town fund account for services rendered. One year from the date of this order the Applicant should start phasing in, over a three year period, the full appropriate charge for the Town's connections.

30. For the most part the Town of Cascade provides water service on an unmetered basis; it recovers the cost of providing water service to consumers in its service area, through the assessment of a monthly flat rate charge for service. One of the monthly flat rates assessed consumers in the proposed rate structure is a \$5.00 monthly surcharge for irrigation. This assessment

assumes that all consumers residing within the service area of the utility have the same irrigation requirement. This is not the case. Consumers have varying sizes of irrigable property, and generally the larger the irrigable area the higher the irrigation demand. The water utility should ascertain the irrigable area for each subscriber and recover its cost of providing irrigation water based on a square footage basis of irrigable area. If the utility were to recover its costs of providing this service in the described manner it would, in the Commission's view, improve the equity in its rate design.

31. The Applicant has never viewed the provision of fire protection as a separate cost center in the operation of its water utility. The provision of fire protection represents a significant cost to the water utility and these costs should be examined and should be recovered through the implementation of a fire hydrant rental fee.

The Applicant's rate proposal includes fire protection cost recovery as a component of the monthly flat rate charge assessed water consumers. This method of recovering costs associated with fire protection is, in the Commission's opinion, inappropriate. Recovery of the fire protection cost through the commodity charges is inequitable because water consumption, on which the monthly rate

is based, has no correlation with fire flow requirements of the customer classifications.

Fire flow requirements in a residential section of the Town's service area are generally lower than those required in a commercial area; therefore, capital costs associated with fire protection in the residential area should be less than in a commercial area. Since fire flow requirements are lower in a residential than commercial area the peaking factor applicable to allocation of this cost will be lower for a residential area.

As shown in the preceding paragraph, variances exist in the cost of providing fire protection to the various customer classifications. In future proceedings before this Commission the Town should be prepared to demonstrate that recovery of fire protection costs consider these variances.

32. The Commission, for purposes of this order will accept the Applicant's proposed rate structure as filed. The Commission is accepting the Applicant's proposed rate structure, as filed, because it does not have adequate information available to make revisions to the rate structure and insure full recovery of the revenue requirement authorized in this order. The Applicant, however, is cautioned that the Commission expects the implementa-

tion of the recommendations discussed in the rate design section of this order.

CONCLUSIONS OF LAW

1. The Applicant, the Town of Cascade, is a public utility as defined in Section 69-3-101, MCA. The Montana Public Service Commission properly exercises jurisdiction over the Applicant's rates. Title 69, Chapter 7, MCA.

2. The Commission has provided adequate public notice and an opportunity to be heard as required by Section 69-3-303, MCA, and Title 2, Chapter 4, MCA.

3. The rates and rate structure approved in this order are just and reasonable. Sections 69-3-201, and 69-3-330, MCA.

ORDER

NOW, THEREFORE, IT IS ORDERED THAT:

1. The Town of Cascade shall file rate schedules, consistent with the Findings of Fact herein, for its Cascade, Montana service area.

2. The Town of Cascade is authorized to issue revenue bonds in the amount of \$725,000 with the requirements as outlined in Finding of Fact No. 22.

3. The Town of Cascade is authorized to file increased rates recognizing operation and maintenance costs and costs associated with the proposed revenue bonds. The rates shall become effective

upon Commission approval subsequent to the issuance of the revenue bonds.

4. The rates approved herein shall not become effective until the tariffs, revenue bond ordinance(s), and necessary calculations relating to debt costs have been submitted for review by the Commission.

DONE IN OPEN SESSION at Helena, Montana, this 10th day of February, 1988, by a 3-0 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

CLYDE JARVIS, Chairman

HOWARD L. ELLIS, Commissioner

TOM MONAHAN, Commissioner

ATTEST:

Ann Purcell
Acting Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.